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July 29, 2020

**Statement by Mr. Merk and Mr. Buetzer on United States**
**(Preliminary)**
**Executive Board Meeting**
**July 31, 2020**

**We thank staff for its comprehensive and insightful set of reports and broadly concur with the appraisal. We also thank Mr. Rosen, Mr. Grohovsky, and Mr. Shenai for their helpful Buff statement.**

The U.S. economy – as many others – entered into a deep recession as Covid-19 started to spread in March. While the public health situation improved substantially in former U.S. epicenters, contagion from the virus is still accelerating in other economically important states. Unemployment in April stood at a height not seen for 90 years, before economic activity and employment rebounded markedly in May after reopening had started. We share staff's view that it will probably take a prolonged period to return to pre-crisis levels and that uncertainty is especially high concerning this year's projection. In particular, uncertainties are associated with a growing number of states pausing the reopening process or reintroducing shutdown restrictions as well as with consumers' self-imposed social distancing measures in the wake of local infections growing again.

**Fiscal support has played a crucial role in mitigating the economic shock and – most probably – more is needed to counter the pandemic and to deliver support to households, businesses, states and local authorities as some support programs will run out soon**. We take note of staff's recommendation of an additional fiscal stimulus amounting to 10 ½ percent of GDP over the next three years. As pointed out, the share of direct support needed was relatively large as the U.S. social safety net is traditionally smaller compared to other advanced economies. This, however, could not prevent disproportional effects of the pandemic on lower-income groups who are often employed in labor-intensive services particularly affected by shutdown measures. Countervailing measures recommended by staff to address such vulnerabilities would contribute to higher living standards for disadvantaged groups and entail positive macroeconomic effects.

**We agree with staff's view that new measures should be targeted to those who are most in need and to policies that provide the greatest stimulus to economic activity and employment to minimize hysteresis effects.**

**However, we also share staff's concern about the sustainability of the U.S. fiscal position and appreciate staff's valuable list of recommendations for a medium-term fiscal policy.** Fiscal consolidation should not be unnecessarily postponed. Moreover, we agree with staff that a medium-term fiscal policy should be geared towards reshaping the tax system, the balancing of federal and state revenues, as well as the financing and design of health care, social assistance and education. We also want to emphasize that structural reforms aimed at increasing potential growth, such as improving the public infrastructure, would ultimately facilitate fiscal consolidation. We also see value in expanding apprenticeship and vocational programs. Concerning the stimulation of additional "green" investments, we back staff's suggestion to use this opportunity to support a more environmentally sustainable growth model through tax and expenditure policies.

**The Federal Reserve's response to the crisis was prompt, decisive and flexible during the last months.** The Fed's measures were targeted at providing short term funding, restoring market functioning and providing credit to non-financial entities with the last set of measures conducted under section 13 (3) of the Federal Reserve Act with fiscal guarantees and through special purpose vehicles.

**We agree with staff that going forward, these activities should be undertaken by the Treasury.** Concerning more traditional monetary policy tools, we take note of staff's recommendation that asset purchases could be scaled up in the coming months to provide more stimulus. However, as staff clarifies, the effectiveness of further purchases of Treasury bonds and mortgage backed securities is likely to be modest and can entail unwanted side effects that require close monitoring.

Beyond that, we would be more cautious in advising the Fed to introduce yield curve control or temporary price level control before the Fed's ongoing review of its monetary policy strategy, its tools, and its communication is finalized. We agree with staff that greater clarity in communication would be valuable and promote confidence in the Fed's ability to balance potential risks and advantages of strengthened forward guidance in a period of elevated uncertainty.

**The crisis once again has highlighted the need for international cooperation. This not only holds for health policy, but also for trade and tax policy. We strongly support staff's clear plea for a joint international effort to address policies that distort trade and investment.** As noted by staff, restrictive trade policies, including countervailing duties, have had negative consequences on the US and global activity and remain an important downside risk.

**We share staff's view that the U.S. financial system proved resilient during the first months of the crisis.** Banks had sufficient capital and liquidity buffers to maintain lending to corporations and households, supported by effective policy measures undertaken by the

Federal Reserve and the Treasury. However, there remain risks in the short to medium-term of increased losses due to the ongoing severe recession, the phasing-out of policy support measures, and, consequently, an increase in the default rate of corporations and households. Vulnerabilities are especially present in the corporate sector, where debt levels have been at record highs already before the crisis and where lending standards have eased. International spillovers of financial stress could be substantial.

**We support the FSSA recommendations that financial stability oversight should be strengthened by implementing explicit mandates for the agencies in charge and by increasing their organizational independence.** In addition, agencies should intensify crisis preparedness as temporary regulatory reliefs during the crisis coincided with an increase in financial stability risk. Moreover, we agree that important data gaps should be closed and macroprudential tools for nonbanks developed, given the migration of risks to these entities in recent years. Finally, as staff points out, it is important that the U.S. maintains its engagement in developing the international financial regulatory architecture and remains committed to the international standards agreed upon.

Lastly, we consider it important that Article IV reports cover, by and large, those topics that were communicated to the authorities in advance and that were addressed during the consultations, even more so in these exceptionally challenging times.